RECEIVED by MSC 8/26/2020 3:58:48 PM

STATE OF MICHIGAN
IN THE SUPREME COURT

LESLIE J. MURPHY, Plaintiff-Appellant, v. SAMUEL M. INMAN, III, JOHN F. SMITH, BERNARD M. GOLDSMITH, WILLIAM O. GRABE, LAWRENCE DAVID HANSEN, ANDREAS MAI, JONATHAN YARON, ENRICO DIGIROLAMO, Defendants-Appellees.	Supreme Court Case No. 161454 Court of Appeals Case No. 345758 Oakland Circuit Court Case No. 2017-159571-CB

PLAINTIFF-APPELLANT'S REPLY IN SUPPORT OF APPLICATION FOR LEAVE TO APPEAL

MACWILLIAMS LAW PC
Sara K. MacWilliams (P67805)
838 W. Long Lake Road, Suite 211
Bloomfield Hills, MI 48302
(248) 432-1586
sm@macwilliamslaw.com

MONTEVERDE & ASSOCIATES PC
Miles D. Schreiner (admitted *pro hac vice* by Circuit Court and Court of Appeals)
Juan E. Monteverde
The Empire State Building
350 Fifth Avenue, Suite 4405
New York, NY 10118
(212) 971-1341
mschreiner@monteverdelaw.com
jmonteverde@monteverdelaw.com

Counsel for Plaintiff-Appellant

August 26, 2020

RECEIVED by MSC 8/26/2020 3:58:48 PM

TABLE OF CONTENTS

RECEIVED by MSC 8/26/2020 3:58:48 PM

TABLE OF AUTHORITIES

CASES **PAGE(S)**

RECEIVED by MSC 8/26/2020 3:58:48 PM

STATUTES

RECEIVED by MSC 8/26/2020 3:58:48 PM

RULES

OTHER AUTHORITIES

RECEIVED by MSC 8/26/2020 3:58:48 PM

INTRODUCTION

Plaintiff's Application presents this Court with a straightforward choice: Does it want to join "the supreme courts of the various states[,]" *Keller v Estate of McRedmond*, 495 SW3d 852, 877 (Tenn, 2016), and resolve an important corporate law issue that the lower courts have botched, or would it rather sit on the sidelines and let the injustice persist? It has been thirty-one years since this Court briefly touched on the pertinent issue in *Christner v Anderson, Nietzke & Co., PC*, 433 Mich 1 (1989), which does not address one of the two primary common law tests for distinguishing direct claims from derivative ones, and did not involve a merger. Since then, the lower courts have issued a handful of unpublished opinions that have left shareholders harmed by directors' breaches of duty orchestrating unfair mergers without any meaningful legal recourse.

This Court should provide much needed clarification on this issue, which "'has many legal consequences'" and "'an expansive impact on the parties to the action.'" *Keller*, 495 SW3d at 869.

ARGUMENT

I. This Court Is The "Principal Steward Of Michigan's Common Law," And It Should Address The Important Corporate Law Issue Presented

Defendants repeatedly warn about "judicial activism[.]" Defendants-Appellees' Answer to Plaintiff-Appellant's Application for Leave to Appeal ("Answer") at 9, 27-28, 35. Those warnings are illogical given that we are talking about *common law* tests for distinguishing direct from derivative claims. "This Court is the principal steward of Michigan's common law." *Henry v Dow Chem Co.*, 473 Mich 63, 83 (2005). "And it is well recognized that rules that were 'judge-invented' can be 'judge-reinvented,' 'judge-uninvented,' or…in this case, '*judge-clarified*.'" *Woodman v Kera LLC*, 486 Mich 228, 271 (2010) (Markman, J., concurring).[1] As the cases cited herein

[1] All emphasis has been added.

illustrate, several other appellate courts have recently recognized that judge-clarification is needed on the pertinent issue. This Court should join them.

It is also important to note why the tests for distinguishing direct from derivative claims are creations of the common law. The Michigan Legislature has adopted various provisions of the Model Business Corporation Act ("Model Act"). *See, e.g., Baks v Moroun*, 227 Mich App 472, 479 n 4 (1998). But "[t]he question of whether a particular claim is derivative or direct is not addressed by the revised Model Corporation Act or by [Michigan] state statutes governing corporations, so the question must be answered by the state courts." *Keller*, 495 SW3d at 869-70.

While Defendants repeatedly reference MCL 450.1541a ("Section 541a"), that statute provides for "[a]n action against a director or officer for failure to perform the duties imposed" therein, Section 541a(4), but it (along with the rest of the Michigan Business Corporation Act) is *silent on the issue of whether a claim is properly characterized as direct or derivative*. Contrary to Defendants' assertion, Plaintiff does not ask this Court to "ignore" the statute—it simply does not address the pertinent issue.[2]

[2] As Plaintiff argued below, Section 541a *does not* limit standing to bring an action under the statute solely to corporations or shareholders acting derivatively on behalf of the corporation, and there is no reason to read such a limitation into the statute. *See Miller v Allstate Ins Co.*, 481 Mich 601, 607 (2008) ("Statutory standing 'simply [entails] statutory interpretation: the question it asks is whether [the Legislature] has accorded *this* injured plaintiff the right to sue the defendant to redress his injury.'"); *Rayford v Detroit*, 132 Mich App 248, 254 (1984) ("'A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover damages from the party in default is implied[.]'").

Furthermore, Defendants' argument that *Estes v Idea Eng'g & Fabricating, Inc.*, 250 Mich App 270, 285 (2002) *holds* that claims under the statute "must be brought by either the corporation itself or by a shareholder as a derivate action[,]" Answer at 18, was correctly rejected by both the federal court and the Court of Appeals. *Murphy v Inman*, No. 17-13293, 2018 US Dist LEXIS 77200, at *9 (ED Mich, Feb 21, 2018); *Murphy v Inman*, unpublished opinion per curiam of the Court of Appeals, issued April 30, 2020 (Docket No. 345758), at 3 (Application, Exhibit 1).

RECEIVED by MSC 8/26/2020 3:58:48 PM

As the Court of Appeals correctly noted, it is a "long-recognized" tenet of Michigan "*common law* that 'the directors of a corporation owe fiduciary duties to stockholders[.]'" *Murphy*, Application Ex. 1 at 4; Application at 13 n 5 (collecting cases). Other courts have also recognized that "[u]nder Michigan law, 'corporate officers and directors owe the fiduciary duty of care and loyalty to the corporation *and to its shareholders*.' *A breach of this fiduciary duty provides a direct cause of action to the shareholders*." *Pittiglio v Mich Nat'l Corp*, 906 F Supp 1145, 1154 (ED Mich, 1995) (collecting cases and quoting *Gaff v Fed Deposit Ins Corp*, 828 F2d 1145, 1151 (CA 6, 1987)).[3] In *Pittiglio*, the court rejected corporate officers' argument that an alleged breach of their duty to maximize shareholder value in a sale was a derivative claim. *Id*. Appellate courts across the country have reached the same conclusion. *E.g.*, *Parnes v Bally Entm't Corp*, 722 A2d 1243, 1245 (Del, 1999); *Cohen v Mirage Resorts, Inc.*, 119 Nev 1, 19 (2003); *Shenker v Laureate*

[3] This body of cases distinguishes Michigan from both Massachusetts and Texas. Massachusetts does not recognize common law fiduciary duties owed by directors to shareholders except in two limited circumstances. *Int'l Bhd of Elec Workers Local No 129 Benefit Fund v Tucci*, 476 Mass 553, 561 (2017). And Texas law similarly provides that "'[a] director's fiduciary duty runs only to the corporation, not to individual shareholders or even to a majority of the shareholders.'" *Somers v Crane*, 295 SW3d 5, 11 (Tex App, 2009). Conversely, Michigan law recognizes that directors *owe shareholders* duties, including the duty to maximize shareholder value and duty of candor. Application at 13 n.5. Thus, Defendants' reliance on *Tucci and Somers* is misplaced. And, to the extent Defendants contend that Section 541a abrogated the significant body of Michigan case law holding that directors owe fiduciary duties to shareholders, that argument is at odds with the well-settled rule that "the common law should not be abrogated by statute unless it clearly appears that was the legislative intent." *Lee v Detroit Med Ctr*, 285 Mich App 51, 67 (2009); *Shenker*, 411 Md at 339. There is no such indication here, as Section 541a was patterned after the Model Act, which explains that "[t]he term 'corporation' is a surrogate for the business enterprise *as well as a frame of reference encompassing the shareholder body*." Model Bus Corp Act § 8.30, cmt. 1. While Defendants are not satisfied with the Model Act's own comment, Answer at 19, this Court has not hesitated to rely upon "the drafter's comment to [a] uniform act" in interpreting statutory text. *MacDonald v State Farm Mut Ins Co.*, 419 Mich 146, 152 (1984). And, if the drafters' comment is not enough, as scholars have explained, "most courts" disagree with the *Tucci* Court's interpretation of the relevant Model Act provision. James D. Cox & Thomas L. Hazen, 3 *Treatise on the Law of Corporations* 15:3 (3d ed.) (December 2019 Update) ("Cox & Hazen, § 15:3").

RECEIVED by MSC 8/26/2020 3:58:48 PM

Educ, Inc., 411 Md 317, 342 (2009).

Defendants have no response for *Parnes*, and their attempt to distinguish *Cohen* and *Shenker* on their facts is unavailing. *See* Answer at 27-28. The holdings in both opinions were not driven by the fact that majority shareholders were named as defendants. Rather, the outcomes were dictated by the commonsense conclusion that shareholders—*not the corporation*—were harmed, because they "lost unique personal property-his or her interest in a specific corporation." *Cohen*,119 Nev at 19; *Shenker*, 411 Md at 346-47.

Eager to preserve the "heads they win tails shareholders lose" status quo, Defendants urge this Court to ignore these opinions.[4] But, in addressing a common law issue, this Court should be guided by "'the accumulated expressions of the various judicial tribunals in their efforts to ascertain what is right and just between individuals in respect to private disputes[.]'" *Price v High Pointe Oil Co.*, 493 Mich 238, 242 (2013). And various judicial tribunals are largely in accord on this issue: "claims giving rise to direct actions are claims that a proposed merger, recapitalization, redemption, or similar transaction unfairly affects minority shareholders." 12B Fletcher Cyclopedia of Corporations, § 5908, *Derivative actions distinguished from individual and nonderivative class actions* (September 2019 Update).

Defendants' insistence that this Court turn a blind eye to the majority of cases from other states is particularly odd given that the common law tests at issue *derived from other jurisdictions in the first place*. In recognizing the duty owed/direct harm approach in *Mich Nat'l Bank v Mudgett*, 178 Mich App 677, 679 (1989), the Court of Appeals cited to an opinion from the U.S. Court of Appeals for the Fifth Circuit, *Schaffer v Universal Rundle Corp*, 397 F2d 893 (CA 5, 1968). And,

[4] Yet Defendants have no problem asking this Court to adopt Delaware law on other corporate law issues when it suits their goal: making it impossible for shareholders to obtain damages for breaches of fiduciary duty in connection with cash-out mergers. Answer at 37-38.

RECEIVED by MSC 8/26/2020 3:58:48 PM

in recognizing the special injury test in *Christner*, the Court of Appeals cited to the legal encyclopedia American Jurisprudence, which obviously summarized the case law of various states. *Christner v Anderson, Nietzke & Co., PC*, 156 Mich App 330, 345 (1986).

Simply put, the common law tests at issue are not unique creations of the Michigan courts—they derived from other jurisdictions and legal treatises decades ago. Over the years, Michigan's lower courts along with those of numerous other states have attempted to follow the same common law tests, but the blending of concepts and addition of unhelpful verbiage has made their application less straightforward than it should be. *See Mudgett*, 178 Mich App at 679 (citing to the Fifth Circuit in first focusing on the concept of to whom the *duty was owed*, and then focusing on whether the *injury* results only from an injury to the corporation in the next sentence); *Keller*, 495 SW3d at 871 ("Some courts have used a single analytical approach, others have utilized two or even three of them in combination."); *see also* Cox & Hazen, § 15:3 ("Courts frequently have great difficulty in classifying a plaintiff's claim as individual or derivative."). That is why the "supreme courts of the various states" have elected to clarify this issue in recent years. *Keller*, 495 SW3d at 877. This Court should join them.

At bottom, most jurisdictions "are in fundamental agreement with the basic distinction":

> [A] wrongful act that depletes corporate assets and thereby injures shareholders only indirectly, by reason of the prior injury to the corporation, should be seen as derivative in character; conversely, a wrongful act that is separate and distinct from any corporate injury, such as one that denies or interferes with the rightful incidents of share ownership, gives rise to a direct action. Sometimes this result has been justified in terms of an "injury" test that looks to whose interests were more directly damaged; at other times, the test has been phrased in terms of the respective rights of the corporation and its shareholders; but regardless of the verbal formula employed, the results have been substantially similar.

2 Am Law Inst, *Principles of Corporate Governance: Analysis and Recommendations* § 7.01, cmt. c.

RECEIVED by MSC 8/26/2020 3:58:48 PM

Unfortunately for Michigan shareholders, the results in the lower courts of this State have not been substantially similar with the correct results reached in most other jurisdictions. While "most courts have properly considered actions" "challenging the improper expulsion" or cashing-out of shareholders "through mergers" as direct actions, *id.*, Michigan's lower courts have refused to acknowledge that shareholders—not the corporation—are the ones exclusively harmed by directors' breaches of duty in connection with orchestrating unfair cash-out mergers. This Court should address the problem.

II. Misclassifying Claims Like Those Asserted By Plaintiff As Derivative Leaves Shareholders With No Meaningful Legal Recourse

Defendants also insist that a derivative lawsuit was a perfectly sufficient legal device for Plaintiff and other aggrieved Covisint shareholders. Answer at 31-33. Defendants misconstrue the nature and purpose of a derivative lawsuit. A shareholder commencing a derivative proceeding is "representing the interests of the corporation and enforcing the right of the corporation." MCL 450.1492a(b); MCL 450.1491a ("'Derivative proceeding' means a civil suit *in the right of a [] corporation*[.]"). And "[b]ecause a derivative suit is being brought on behalf of the corporation, the recovery, if any, *must go to the corporation*." *Tooley v Donaldson, Lufkin, & Jenrette, Inc.*, 845 A2d 1031, 1036 (Del, 2004). But, as the authorities Plaintiff relies upon make clear, the interest of the corporation is "*in no way implicated*" in an action alleging directors breached the fiduciary duties they owed to shareholders in conjunction with orchestrating an unfair cash-out merger. *Shenker*, 411 Md at 347.

Furthermore, neither Defendants nor the outlier *Tucci* opinion they rely upon have an answer for why any rational shareholder would pursue an action on behalf of a corporation that they no longer hold any ownership stake in, and that has either ceased to exist or become a subsidiary of the acquiring entity. The obvious answer is that no one would pursue such an

RECEIVED by MSC 8/26/2020 3:58:48 PM

“absurd” action because, even if they prevailed, “the surviving entity which was benefitted rather than harmed by the breach” of the directors would be the sole beneficiary of any recovery. Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies*, 58 Baylor L Rev 63, 91 (2006). Thus, telling shareholders to bring a derivative action is the same as telling them to go pound sand. Notably, in its unpersuasive passage asserting that a derivative lawsuit provides cashed-out shareholders with an adequate remedy, the *Tucci* Court failed to address the fact that any recovery in a derivative action *belongs to the acquired corporation or its acquirer, not the cashed-out aggrieved shareholders*. *See Tucci*, 476 Mass at 563-64. That is why leading corporate law scholars have referred to the holding in *Tucci* as a “startling conclusion[.]” Cox & Hazen, § 15:3. Poorly reasoned is another appropriate description, which is likely why *Tucci* has not been cited by a single court outside Massachusetts. While Defendants unsurprisingly seek to maintain the inequitable regime embraced by *Tucci* and the courts below, this Court should remedy the “absurd result[].” *Kleinberger*, 58 Baylor L Rev at 91.

Defendants also argue this Court should decline to follow the weight of authority because, unlike other jurisdictions, Michigan does not have a “continuous ownership rule.” Answer at 28, 32 (citing MCL 450.1492a). That argument once again misses the more fundamental point—a derivative proceeding is simply not the correct legal vehicle for claims like Plaintiff’s, because a derivative suit is brought in the right of the corporation and “the recovery, if any, must go to the corporation[,]” *Tooley*, 845 A2d at 1036, which means the cashed-out shareholders have nothing to gain.

Furthermore, even if a derivative action made logical sense in this context (it does not), MCL 450.1492a(c) requires the proceeding to be “commenced prior to the termination of the former shareholder’s status as a shareholder[,]” *i.e.*, before the merger is consummated. This

RECEIVED by MSC 8/26/2020 3:58:48 PM

requirement creates a ripeness problem for shareholders: "Prior to the merger, such an innocent shareholder could not bring an action given the lack of ripeness of the claim, *i.e.*, the financial harm would have yet to occur." *Moore v Macquarie Infrastructure Real Assets*, 258 So 3d 750, 757 (La App 3 Cir 12/13/17); *see also Mich Chiropractic Council v Comm'r of the Office of Fin & Ins Servs*, 475 Mich 363, 371 n 14 (2006) ("Ripeness prevents the adjudication of hypothetical or contingent claims before an actual injury has been sustained.").[5]

Defendants also contend that shareholders had sufficient recourse because they could have voted against the deal. Answer at 31. That argument was rejected by the Michigan Legislature in 2008 when it added subsection (4) to MCL 450.1545a, which provides that *even if* all "[t]he material facts of the transaction…were disclosed" to shareholders, that still "*does not preclude* other claims relating to a transaction in which a director or officer is determined to have an interest." *Id.*; *see also* Justin G. Klimko, *New Amendments to the Michigan Business Corporation Act*, The Michigan Business Law Journal, Volume 29, Issue 1, 13-14 (Spring 2009) (explaining the provision was added "to reverse the outcome of *Camden v Kaufman*, 240 Mich App 389 (2000)" and allows "a transaction with an interested director or officer [to] be subject to attack for other defects, such as …breach of fiduciary or other duties"). And here, all the "material facts of

[5] While Defendants note that Plaintiff filed his initial complaint before the merger closed, that was because in this particular case, in addition to "charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price[,]" *Parnes*, 722 A2d at 1245, the proxy statement soliciting shareholder approval was materially deficient. Thus, while Plaintiff's breach of candor claim was ripe when he filed his initial complaint, his prayer for money damages resulting from Defendants' failure to maximize shareholder value was not. *Moore*, 258 So 3d at 757. That claim did not become ripe until after the merger closed.

Furthermore, Defendants' contention that Plaintiff "waived his duty of candor claim by failing to raise it before the Circuit Court" is meritless, Answer at 21, and was already rejected by the Court of Appeals, *which addressed Plaintiff's duty of candor claim*. *Murphy*, Application Ex. 1 at 2, 5. *See also* Appellees' Appendix Volume D, Exhibit 13 (Plaintiff's Opposition to MSD), 036d-037d, 045d n 8, 055d-058d; Volume D, Exhibit 12 (MSD Hearing Transcript), 019d-021d.

RECEIVED by MSC 8/26/2020 3:58:48 PM

the transaction" were *not* disclosed to shareholders, MCL 450.1545a(1)(c), since Defendants declined to address several proxy disclosure deficiencies raised in Plaintiff's complaints (which the lawyers in the federal actions abandoned in exchange for attorneys' fees). *See supra* n 5.

Furthermore, even if Defendants had fixed the proxy deficiencies that Plaintiff was able to identify, Defendants' argument that the vote offered sufficient protection ignores the "asymmetric information problems" shareholders face. Kenju Watanabe, *Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex post Policing*, 36 NW J Int'l L & Bus 45, 68 (2016). Specifically, it is impossible for "shareholders to know if the disclosure is adequate unless they have access to undisclosed information[,]" particularly given that fiduciaries often "try to finesse their public disclosure to avoid giving any hint of impropriety." *Id*.

Defendants' argument also ignores that, by the time of the vote, the directors' breaches have already occurred and shareholders face a Hobson's choice: rejecting the deal is likely to come with various negative consequences, including an immediate decrease in the share price and the strong likelihood that strategic alternatives that were once available no longer are.

Accordingly, Defendants' contention that the shareholder vote reflected the true, uninhibited "will of the majority of shares" is baseless. Answer at 10, 31. As one court aptly noted, "[t]hat an investor voted for the merger is not strong evidence that the investor does not 'share Plaintiff's complaints about the merger[].'" *Schulein v Petroleum Dev Corp.*, No. SACV 11-1891 AG (ANx), 2014 US Dist LEXIS 4154, at *11 (CD Cal, Jan 6, 2014).

Defendants also criticize Plaintiff for declining to pursue an injunction under the federal securities laws that would have prohibited the shareholder vote from going forward until the proxy was supplemented. Answer at 32. However, a disclosure-based injunction would not have remedied Defendants' failure to maximize shareholder value. Furthermore, Plaintiff and his

RECEIVED by MSC 8/26/2020 3:58:48 PM

counsel were not interested in abandoning shareholders' damages claims in exchange for attorneys' fees. *See In re Walgreen Co. Stockholder Litig*, 832 F3d 718 (CA 7, 2016) (criticizing such "disclosure-only" litigation). Simply put, Defendants' critique of Plaintiff's litigation strategy, along with their assertion that the vote provided an adequate remedy, are both meritless.

III. Defendants' "Alternate" Arguments Are Procedurally Improper, And Meritless

Defendants also improperly raise alternate arguments that the lower courts did not reach. Answer at 36-40. Pursuant to MCR 7.305(B), Plaintiff's Application explains why there are valid grounds for granting leave to appeal on the *only question properly presented for review*—whether Plaintiff's claims were erroneously characterized as derivative. That is the sole basis upon which the lower courts granted and affirmed Defendants' summary disposition motion, and neither court addressed Defendants' alternative arguments.

Pursuant to MCR 7.305(H)(4)(b), if Plaintiff's Application is granted, Defendants may by separate motion "request to add additional issues not raised in the application for leave to appeal[,]", but their Answer to Plaintiff's Application cannot serve that function. *See id*. (requiring a motion establishing good cause); *see also Gallagher v Persha*, 315 Mich App 647, 666 (2016) ("[A]ppellate review is limited to issues that the lower court actually decided[.]").

Furthermore, even if Defendants' alternate arguments were properly before the Court, they fail for the reasons set forth in both Plaintiff's Brief in Opposition to Defendants' Motion for Summary Disposition (Appellees' Appendix Volume, D, Exhibit 13) and his Reply Brief filed with the Court of Appeals. Plaintiff incorporates those arguments herein to the extent this Court wishes to consider Defendants' meritless alternate grounds for affirmance.

CONCLUSION

This Court should address this corporate law issue of "critical significance[,]" Cox & Hazen, § 15:3, and grant Plaintiff leave to appeal or reverse the lowers courts' orders and remand.

RECEIVED by MSC 8/26/2020 3:58:48 PM

Dated: August 26, 2020

Respectfully submitted,

MACWILLIAMS LAW PC

By: /s/ Sara K. MacWilliams
Sara K. MacWilliams (P67805)
838 W. Long Lake Road, Suite 211
Bloomfield Hills, MI 48302 (248)
432-1586
sm@macwilliamslaw.com

Of Counsel

MONTEVERDE & ASSOCIATES PC
Miles D. Schreiner (admitted *pro hac vice* by
Circuit Court and Court of Appeals)
Juan E. Monteverde
350 Fifth Avenue, Suite 4405
New York, NY 10118
(212) 971-1341
mschreiner@monteverdelaw.com
jmonteverde@monteverdelaw.com

Counsel for Plaintiff-Appellant

RECEIVED by MSC 8/26/2020 3:58:48 PM